

Our Strategies versus the “Risk Trade”

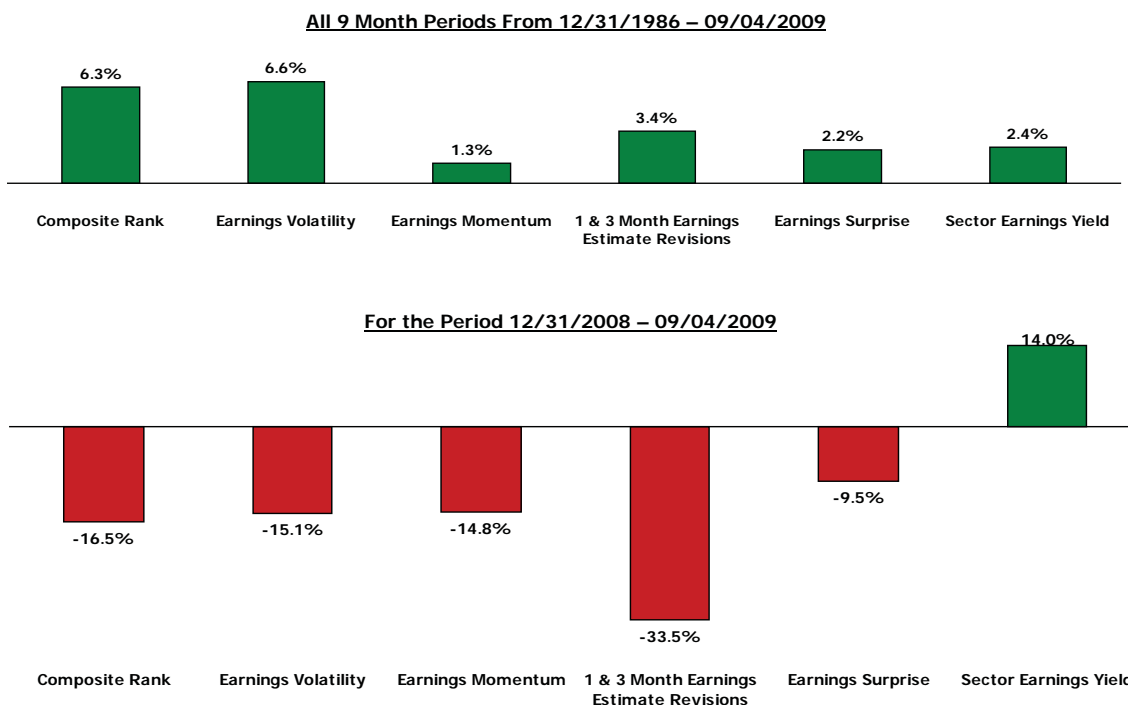
Our investment strategies at Lowe, Brockenbrough & Company are intended to produce better than market results over longer term market cycles. Our primary equity strategies are built on solid research covering over twenty years, which validates our belief that portfolios of stocks with steadier, above average earnings growth, selling at attractive relative valuations, produce superior results. Our fixed income strategies emphasize high quality portfolios with intermediate maturity ranges that protect well in volatile markets and produce a stream of income for clients. However, over the short time frame of the last few months, these strategies have not fully participated in the unprecedented market advance driven by the “Risk Trade.”

The “Risk Trade” is the popular lexicon for investing in higher risk/beta stocks and bonds in an effort to outpace market momentum. Beginning in the summer, with initial evidence of improving economic data off a low base and with little rise in interest rates, investors seeking higher returns began a more aggressive shift into riskier assets. Within the fixed income category, the move out the risk curve has meant greater demand for lower quality corporate bonds, junk bonds, and even emerging market debt, resulting in higher returns for those riskier sectors. The divergence in quality has played out in the equity markets as well. Cyclical equities, whose prices and earnings were decimated in the previous down cycle, have been feverishly bought up. In many cases, current valuations on these stocks are being justified by 2011 or 2012 earnings estimates, valuing them near peak earnings multiples. Many of these cyclical stocks have seen nice bounces off market bottoms in past cycles, but the speed and degree of the current move is unprecedented.

A recent Citigroup report shows that over the 16 months prior to May 2009, domestic stocks suffered a decline of 40% in 12 month forward earnings estimates. This was far greater than the 25% decline after September 11, 2001, and the largest in over 20 years of data. Earnings estimates have now begun to stabilize, rising 9% off a cyclical low base. Forecasts for more cyclical companies are rising faster, after declining the greatest amount in the prior period. Turning points in earnings forecasts such as we are now experiencing have traditionally produced periods in which investment processes using earnings-based factors have lagged in relative performance. This time period is no exception, and has been magnified by the amplitude of the previous decline in earnings estimates. In this atmosphere, companies with relatively steady earnings increases this year and next have received little investor attention.

Over the last 22 years of research and real time experience, the five primary factors Lowe, Brockenbrough uses in our earnings-based equity strategies have enjoyed a meaningful positive spread between the highest and lowest ranked stocks in our universe. But, in the nine months so far this year, the four factors related to earnings - volatility, momentum, revisions and surprise - have experienced sharply inverse results. Only one, the sector valuation factor, has produced results as expected.

Return Difference in Top Comp Ranked Stocks (1 & 2’s) and Bottom Comp Ranked Stocks (9 & 10’s)



SECOND QUARTER 2009 MARKET COMMENTARY AND OUTLOOK

However, as actual earnings momentum begins to turn, the relative performance of earnings-based strategies have historically reverted to more positive patterns. The following chart demonstrates our continued adherence and commitment to our investment process and philosophy. Our model equity portfolio characteristics exhibit greater stability in earnings growth relative to the market, with now even more attractive relative valuations.

Earnings Driven Portfolio Holdings Characteristics

As of 9/30/09

EPS Growth	Earnings Driven	S&P 500 Cap Weighted	S&P 500 Equal Weighted
Last 5 Years EPS Growth	14.1%	-9.0%	-2.0%
Last 10 Years EPS Growth	12.1%	-2.0%	4.0%
2010 Projected EPS Growth	13.0%	28.0%	23.0%
2011 Projected Growth	14.0%	18.0%	19.0%

Valuation	Earnings Driven	S&P 500 Cap Weighted	S&P 500 Equal Weighted
P/E on 2010 Estimate	12.5	15.1	15.0
20 Year Average Forward P/E	17.0	16.9	17.8
Forward P/E as % of LT Average	73.5%	89.3%	84.3%
Forward P/E to LT Growth Estimate	1.3	2.2	1.9

The equity portfolio holdings characteristics are derived using a weighted average of the securities in a model portfolio that is representative of the Earnings Driven process.

In addition to our earnings-based strategies lagging overall market returns during this rally, it is worth noting that most other “quality-based” equity strategies have underperformed as well, including those strategies based on high quality rankings, dividend growth, and dividend yield. Of course, it was just these strategies that outperformed during a difficult 2008. Over the long term, we have seen temporary periods when our strategies did not produce returns as high as the overall market, but rarely have these strategies produced the extraordinarily low relative valuation levels we see in our portfolios today.

In the past 10 recoveries, GDP (Gross Domestic Product) returned to its previous peak within 12 months. With the structural damage and system-wide de-leveraging produced by this recession, it may take years instead of months for GDP to return to 2007 levels. After an initial spurt off the bottom, we anticipate a slower economic recovery going forward, with higher budget deficits, chronic unemployment and below-trend consumer spending. In this scenario, we believe the strong relative performance of cyclical, higher risk stocks will quickly run its course. Then, steadier growth, reasonably valued stocks will reassert themselves as they have done in the past, augmented this time by low relative valuations and low interest rate investment alternatives.